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LAW DEPARTMENT

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October 9, 2008

Mike Gleason, Chairman
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, Arizona 85007

Re: Docket No. E-01345A-08-0172 (Interim Rate Motion) – Your
Letter of October 3, 2008

Dear Chairman Gleason:

On October 3, 2008, you filed a letter in which you requested that Arizona Public Service Company ("APS" or "Company") provide a citation to an "analysis" of the \$1 billion in higher interest costs over 10 years resulting from a downgrade of the Company to sub-investment grade. Of course, as noted in your letter, Mr. Brandt's sworn testimony set forth on the record this figure on many occasions, beginning with pages 4 and 13 of his Affidavit (APS Exhibit 1), which shows an annual range by 2019 of \$70 million (during good markets) to \$145 million (in poorer markets).

No party to the proceeding challenged Mr. Brandt's calculation and several, including Staff, have cited it in their post-hearing briefs. However, information regarding the calculation comes at Tr. Vol. 3, pages 512-516, wherein Mr. Brandt refers to his Direct Testimony in the general rate case, which has a more detailed explanation of the components of the higher costs resulting from a downgrade at pages 44-50. I have attached those pages from Mr. Brandt's Direct Testimony for your convenience as Appendix A.

The \$1 billion figure had its origin in the Company's 2006 interim rate proceeding, which resulted in the Commission granting APS interim relief through an interim PSA surcharge. *See* Decision No. 68685 (May 5, 2006). In that proceeding, Mr. Brandt attached to his Rebuttal Testimony (Attachment DEB-24) a very detailed calculation of the potential spread of interest costs as between BBB- and BB+, showing a range of impacts between \$623 million and \$1.24 billion. And as discussed in Mr. Brandt's general rate case testimony cited above and referenced during the interim rate hearing, there are some other costs that would be added to the difference

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in interest costs.¹ Such additional costs relate to increased demands for collateral and even pre-payments with regard to purchased power and other goods and services, increased costs for credit support instruments such as letters of credit, and revolving credit facility fees. In that 2006 proceeding, as in the current matter, there was no dispute concerning the accuracy of Mr. Brandt's calculation, the details of which were provided to Commission Staff during discovery. The original 2006 calculation used in the prior Commission proceeding is attached as Appendix B.

To this explanation, I would add that these calculations all assume that APS would continue to have access to capital in the "junk" bond market at ANY cost. That assumption is very much in doubt today. Mr. Brandt, Mr. Post and every Staff and intervenor witness in this proceeding agreed that access to capital would, at the very least, be much more restrictive should APS be further downgraded. As Mr. Brandt and several other witnesses made clear, many institutional investors who typically purchase debt securities of the kind issued by APS are not permitted by their internal rules or their published investment criteria to purchase junk-rated debt securities. And as was noted in the post-hearing brief of the Arizona Investment Council at page 3, the present credit market has discouraged even higher rated utilities than APS from issuing new debt. This phenomenon has continued, as the article from yesterday's *Bloomberg.com* website indicates. A copy of such article is attached as Appendix C. Certainly during bad markets, such as presently exist, access by non-investment grade entities to the capital market is likely non-existent. And, over the past 15 months, APS has continuously experienced difficulty in accessing commercial paper with the market now being completely closed to APS, even though it is currently rated as an investment grade borrower (though near "junk" levels). On October 8, 2008, Commission Mayes sent Mr. Brandt a letter requesting, among other things, that APS indicate what impact the current credit crisis has had on APS's access to credit. The Company's response to Commissioner Mayes' letter will therefore address that issue in greater detail.

I hope this letter has been responsive to your inquiry. Please do not hesitate to contact me or other Company representatives should you require additional information.

Sincerely,



Thomas L. Mumaw

Attorney for Arizona Public Service Company

¹ Because of these additional non-interest costs and the need to maintain greater than 1x coverage for the higher interest costs themselves, the ultimate impact on APS customers would be somewhat greater than just the differential in interest between BBB- and BB+. In addition, rates would increase on the Company's existing credit lines and other short-term borrowing by as much as one percent or more.

Mike Gleason, Chairman

October 9, 2008

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Attachments

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Kristen K. Mayes, Commissioner
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Appendix A

1 charge). A fundamental tenet of utility regulation is that customers require a
2 financially healthy utility so that rates remain reasonable and service remains
3 reliable. And the financial health of APS—dependent upon the revenue it is
4 authorized to receive and the credit metrics it is able to achieve—is almost
5 exclusively within the Commission's control.

6 These facts are not new to the Commission. Indeed, the Commission has
7 historically recognized the very real importance of credit ratings, declaring that
8 "the benefits of [higher bond] ratings inure to both the utility and the utility rate
9 payer. We believe that sound and responsible regulatory action by this
10 Commission is fundamental to the maintenance of desirable bond ratings."
11 Decision No. 51009 (May 29, 1980). For this reason, as described below, the
12 ultimate goal of APS in this proceeding is not only to obtain the requested rate
13 relief that will allow APS to maintain its BBB- investment status in the short
14 term, but also to establish a longer-term process that will restore the Company's
15 financial health and return its credit ratings to the high BBB/low A range over
16 the next several years.

17
18 **Q. PLEASE ELABORATE ON THE CONSEQUENCES TO APS AND ITS**
19 **CUSTOMERS IF THE COMPANY IS DOWNGRADED TO NON-**
20 **INVESTMENT GRADE.**

21 A. The adverse consequences of APS having its credit rating downgraded to junk
22 would be immediate, serious, and long-term. The following is just a sample of
23 the problems that come with non-investment grade credit ratings:

- 24 • With limited financial flexibility, APS's access to the debt and equity
25 markets would itself become limited to those lenders and investors (if
26 any) willing to take the risk on a junk grade company.

- 1 • Investors will demand a higher yield for an investment in a company with
2 low credit ratings in order to compensate them for their increased risk, a
3 factor that raises the cost of APS's capital at a time when capital
4 requirements are extreme. Any debt or equity issued by APS would thus
5 come with significantly increased costs due to the high interest rates and
6 fees that inevitably accompany a junk credit status. As a result, by 2019,
7 the Company's financing costs recoverable from customers could
8 increase by as much as \$70 million to \$145 million per year over what
9 they would have been absent a downgrade. This is the equivalent of a 2.7
10 to 5.5 percent rate increase to customers for each year that the Company
11 remains non-investment grade.
- 12 • APS and its customers would lose much of the cost-savings currently
13 enjoyed because of the financing arrangements underpinning the
14 Company's \$656 million dollars in outstanding tax-exempt debt. This
15 debt requires letters of credit from banks or other third party insurance to
16 support its creditworthiness, and pricing for that support is based
17 exclusively on APS's credit ratings. A downgrade to junk status will
18 significantly increase those costs by as much as \$1.8 million per year,
19 which costs are ultimately borne by APS customers in the form of higher
20 base rates.
- 21 • APS's access to commercial paper—a cost-effective financing
22 mechanism on which APS heavily relies for its working capital needs—
23 would be completely eliminated. APS's average outstanding commercial
24 paper debt is roughly \$200 million, although that number could easily
25 double at the peak of the Company's liquidity needs. APS's commercial
26 paper is now rated A-3/F-3/P-2, which places it squarely in the limited

1 Tier-2 and Tier-3 market. Many commercial paper buyers have
2 investment policies prohibiting them from purchasing APS's commercial
3 paper because of APS's weak credit rating (indeed, only 4% of all
4 commercial paper buyers are in the Tier-2 and Tier-3 market). For this
5 reason, access to the commercial paper market has been a problem for
6 APS on two separate occasions in the second half of 2007 when the
7 financial markets were under stress. Should APS be further downgraded
8 to non-investment levels, its access to the commercial paper market
9 would be eliminated completely, and APS would lose all of the cost
10 advantages that come with commercial paper, including daily liquidity
11 and competitive pricing. APS would thus be forced to turn to more costly
12 revolving credit agreements to satisfy its daily working capital needs,
13 increasing APS's overall borrowing cost by \$1.7 million annually. This
14 increase, of course, ultimately leads to rising energy prices for APS
15 customers.

- 16 • APS may also lose many of its important existing bank credit agreements
17 if forced to fight for renewal of those facilities with a lowered credit
18 status. The few banks that might renew these existing agreements would
19 demand significantly higher prices and more onerous covenants that, in
20 the event of increased financial stress, could drive APS into default and
21 bankruptcy.
- 22 • Most of the Company's purchased power contracts contain provisions
23 that require APS, in the event of a downgrade to non-investment status, to
24 provide the counter-party with cash collateral (a "collateral call") to cover
25 the difference between the contract price and the then-existing market
26 price of the commodity. High levels of collateral calls could place a

1 significant liquidity strain on APS at a time when the Company's access
2 to the capital markets is already restricted.

- 3 • If downgraded, many of the Company's purchased power and fuel
4 contracts include prepayment provisions, requiring the Company to
5 provide up-front cash payments for the Company's purchased power,
6 power plant fuel and fuel transportation needs. APS's cost of doing
7 business in the wholesale markets would increase significantly under
8 such provisions, and the Company's ability to hedge against price
9 volatility would be constrained, further increasing the Company's risk
10 profile.

11 **Q. WOULD ANY OTHER CONSEQUENCES RESULT FROM A**
12 **DOWNGRADE TO JUNK GRADE?**

13 A. Yes. Of all of the consequences described above, my greatest fear is that, if
14 downgraded to junk, APS might entirely lose its access to the credit markets. In
15 the last rate case, I testified that when credit markets are such that "investors in
16 general have experienced a general decline in confidence, they regularly turn to
17 what they perceive as less risky investments," and that, as a result, "non-
18 investment grade issuers can find themselves shut out from sources of funding at
19 the very time that they require them most." [Rebuttal Testimony of Donald E.
20 Brandt, Docket No. E-01345A-05-0816, September 15, 2006]. That unstable
21 credit market exists today. What began as a disruption in mortgage-related
22 securities in the summer of 2007 has spread like a contagion throughout the debt
23 and equity capital markets. Current financial markets are now in the very state
24 of extreme volatility to which I referred in September of 2006, causing an
25 increase in APS's financing costs even with the Company's current investment
26

1 grade credit rating. And, as I indicated in the last rate case would be true in such
2 an environment, this highly volatile credit market has at times been closed to
3 companies with below investment grade ratings.

4 APS has already experienced first-hand the volatility in the credit markets. For
5 example, the mortgage-related securities market began experiencing difficulties
6 in the summer of 2007. At that time, it became apparent that the default rates on
7 so-called sub-prime mortgages were much higher than the market had assumed.
8 This impacted the short-term debt markets for both mortgage-backed
9 commercial paper programs as well as all other commercial paper programs. In
10 August 2007, many issuers, including Pinnacle West, were not able to access the
11 market and were forced to turn to bank credit to fund their working capital
12 needs. The situation stabilized to a minor degree in the fall of 2007, but by
13 December had once again deteriorated. APS entered the commercial paper
14 market in mid-December and began experiencing historically high rates. As
15 year-end approached, APS was unable to sell its commercial paper into the
16 market and was forced to borrow over \$200 million under its existing credit
17 facilities to fund its short-term debt needs in late December. Additionally, most
18 of the commercial banks that APS has turned to for liquidity and credit support
19 have had to take massive, multi-billion dollar write-downs on their books related
20 to investments in sub-prime mortgage products, severely impacting the amount
21 of capital the banks have available for lending. This has resulted in a credit
22 market in which supply has become limited yet demand has increased—a
23 market from which a junk grade borrower will unlikely be able to borrow and in
24 which interest rates will increase.
25
26

1 APS has experienced other negative financial impacts as a result of the credit
2 market turmoil, even in its current investment grade position. For example, the
3 Company has \$343 million of long-term pollution control bonds that are sold to
4 investors as auction-rate securities. Even though these securities are long-term,
5 they trade in what has historically been a very liquid short-term market. This
6 has allowed APS to fund long-term obligations at significantly lower short-term
7 interest rates that reset weekly. In 2007, APS's pollution control bonds traded in
8 the auction-rate market at interest rates that averaged about 3.5%. But, to accept
9 the extremely low interest rates paid on auction-rate securities, investors require
10 a guarantee that they will receive their interest and principal payments when
11 due. This guarantee is provided by AAA-rated bond insurance.

12 In late 2007, credit rating agencies announced that some of the bond insurers
13 appeared to have insufficient capital to cover their exposure in the sub-prime
14 market—thus putting the AAA ratings at risk. In January of 2008, the bond
15 insurer that backs APS's auction-rate securities, Ambac Financial Group, Inc.,
16 was downgraded from AAA to AA by Fitch Ratings. The Ambac downgrade
17 flowed through to the bonds it insures, including APS's \$343 million of auction-
18 rate securities. The auction-rate market has since seen a dramatic loss of
19 investors. If there are no willing buyers of the securities when they come up for
20 auction, the existing bondholders are forced hold the bonds until the next
21 auction. As compensation for holding what may be unmarketable securities, the
22 existing holders are paid a premium rate—in the case of APS's securities, this
23 rate is 14%—four times what it had been just last year. APS needs to maintain
24 its investment grade credit ratings to be able to implement economic alternatives
25 and to avoid paying a 14% rate on these securities.
26

1 Q. AREN'T THE CONSEQUENCES FROM DOWNGRADE THAT YOU
2 HAVE JUST DESCRIBED SPECULATIVE?

3 A. No, they are not. The costly consequences resulting from a downgrade to non-
4 investment status are neither speculative nor overstated, as confirmed by the
5 experience of Nevada Power Company ("Nevada Power"), which was saddled
6 with hundreds of millions of dollars of added costs and onerous borrowing
7 restrictions as a result of their slide into "junk" status.

8 In a March 29, 2002 decision (Docket No. 01-11029), the Nevada Public
9 Utilities Commission ("NPUC") disallowed a significant amount of deferred
10 fuel and purchased power expense for Nevada Power. As a result, credit rating
11 agencies lowered Nevada's senior debt securities ratings to junk grade, and
12 Nevada promptly lost access to short-term debt markets. The resultant costs to
13 Nevada Power and its customers have been extreme, increasing the cost of debt
14 by more than \$110 million *annually*, motivating the NPUC to implement several
15 initiatives aimed at restoring Nevada to an investment grade position in the
16 capital markets. For example, the NPUC enhanced the return on equity
17 applicable to designated "critical facilities" (including those that protect
18 reliability, promote diversity of supply, promote renewable energy or are
19 statutorily mandated), authorized Nevada Power to include a portion of the
20 utility's Construction Work in Progress ("CWIP") account balance in rate base
21 in the Company's last rate case, enhanced the return on equity for approved
22 DSM project costs, and implemented an automatic fuel cost adjustor. Even the
23 Nevada legislature reacted to Nevada Power's downgrade by enacting statutes
24 geared towards encouraging a positive regulatory environment.
25
26

Appendix B

Low Spread

ARIZONA PUBLIC SERVICE COMPANY
Additional Interest Costs at Non-Investment Grade
(\$000)

YEAR	SECURITY	CREDIT	FACE VALUE	CURRENT RATE/FEE	BIG RATE/FEE	COST DIFFERENTIAL	ADDITIONAL ANNUAL INTEREST	CUMULATIVE ADDITIONAL INTEREST
2006	<u>Short-Term Debt:</u>							
	CP		200,000	0.510%	1.050%	1,080		
	<u>Auction Rate Tax-Exempt Insured:</u>							
2006	Coc 2004A		12,850	0.325%	0.800%	61		
2006	Nav 2004A-E		166,150	0.325%	0.800%	789		
2006	Mar 2005A-E		163,975	0.265%	0.665%	656		
	<u>Auction Rate Tax-Exempt Insured Subtotal</u>		<u>342,975</u>			<u>1,506</u>		
	<u>Tax-Exempt w/ L/C:</u>							
2006	Farm 1994A-C		146,650	0.500%	1.500%	1,467		
2006	Coc 1994A & 1998		49,520	0.600%	1.700%	545		
	<u>Tax-Exempt w/ L/C Subtotal</u>		<u>196,170</u>			<u>2,011</u>		
	<u>New Taxable Debt</u>							
2006	Sr. Note		250,000	0.000%	2.265%	5,663	10,260	10,260
2007	Sr. Note		550,000	0.000%	2.265%	12,458	22,717	32,977
2008	Sr. Note		500,000	0.000%	2.265%	11,325	34,042	67,020
2009	Sr. Note		625,000	0.000%	2.265%	14,156	48,199	115,218
	<u>New(N)/Refinanced(R) LTI Debt:</u>							
2010	Sr. Note (N)		250,000	0.000%	2.265%	5,663	53,861	169,079
2011	6.375% Sr. Note (R)		400,000	0.000%	2.265%	9,060	0	0
2011	Sr. Note (N)		250,000	0.000%	2.265%	5,663	68,584	237,663
2012	6.5% Sr. Note (R)		375,000	0.000%	2.265%	8,494	0	0
2012	Sr. Note (N)		250,000	0.000%	2.265%	5,663	82,740	320,403
2013	Mar 2002A (R)		90,000	0.450%	0.600%	135	0	0
2013	Sr. Note (N)		250,000	0.000%	2.265%	5,663	88,537	408,940
2014	5.8% Sr. Note (R)		300,000	0.000%	2.265%	6,795	0	0
2014	Sr. Note (N)		250,000	0.000%	2.265%	5,663	100,995	509,935
2015	4.65% Sr. Note (R)		300,000	0.000%	2.265%	6,795	0	0
2015	Sr. Note (N)		250,000	0.000%	2.265%	5,663	113,452	623,387

High Spread

ARIZONA PUBLIC SERVICE COMPANY
Additional Interest Costs at Non-Investment Grade
 (\$000)

YEAR	SECURITY	CREDIT	FACE VALUE	CURRENT RATE/FEE	BIG RATE/FEE	COST DIFFERENTIAL	ADDITIONAL ANNUAL INTEREST	CUMULATIVE ADDITIONAL INTEREST
2006	<u>Short-Term Debt:</u>							
	CP		200,000	0.510%	1.050%	1,080		
2006	<u>Auction Rate Tax-Exempt Insured:</u>							
	Coc 2004A		12,850	0.325%	0.800%	61		
2006	Nav 2004A-E		166,150	0.325%	0.800%	789		
2006	Mar 2005A-E		163,975	0.265%	0.665%	656		
	<u>Auction Rate Tax-Exempt Insured Subtotal</u>		<u>342,975</u>			<u>1,506</u>		
2006	<u>Tax-Exempt w/ L/C:</u>							
	Farm 1994A-C		146,650	0.500%	1.500%	1,467		
2006	Coc 1994A & 1998		49,520	0.600%	1.700%	545		
	<u>Tax-Exempt w/ L/C Subtotal</u>		<u>196,170</u>			<u>2,011</u>		
2006	<u>New Taxable Debt</u>		250,000	0.000%	4.680%	11,700	16,297	16,297
2007	Sr. Note		550,000	0.000%	4.680%	25,740	42,037	58,335
2008	Sr. Note		500,000	0.000%	4.680%	23,400	65,437	123,772
2009	Sr. Note		625,000	0.000%	4.680%	29,250	94,687	218,459
2010	<u>New(N)/Refinanced(R) LT Debt:</u>							
	Sr. Note (N)		250,000	0.000%	4.680%	11,700	106,387	324,847
2011	6.375% Sr. Note (R)		400,000	0.000%	4.680%	18,720	0	0
2011	Sr. Note (N)		250,000	0.000%	4.680%	11,700	136,807	481,854
2012	6.5% Sr. Note (R)		375,000	0.000%	4.680%	17,550	0	0
2012	Sr. Note (N)		250,000	0.000%	4.680%	11,700	166,057	627,712
2013	Mar 2002A (R)		90,000	0.450%	0.600%	135	0	0
2013	Sr. Note (N)		250,000	0.000%	4.680%	11,700	177,892	805,604
2014	5.8% Sr. Note (R)		300,000	0.000%	4.680%	14,040	0	0
2014	Sr. Note (N)		250,000	0.000%	4.680%	11,700	203,632	1,009,236
2015	4.65% Sr. Note (R)		300,000	0.000%	4.680%	14,040	0	0
2015	Sr. Note (N)		250,000	0.000%	4.680%	11,700	229,372	1,238,608

Appendix C



Overnight CP Costs Jump, Bond Risk Rises Amid Global Rate Cuts

By Bryan Keogh

Oct. 8 (Bloomberg) -- Overnight corporate borrowing costs jumped, default risk increased and the bond market remained all but closed after central banks worldwide cut interest rates, showing unprecedented government intervention was failing to aid companies struggling to finance themselves.

Overnight rates on dealer-placed commercial paper rose 56 basis points to 3.5 percent, while the cost of protecting corporate bonds from default rose. Two issuers sold \$750 million of U.S. company bonds this week, compared with the weekly average this year of \$16.8 billion.

The coordinated rate cuts come as companies struggle to fund daily operations and economists say the world is already mired in a recession. The Federal Reserve joined the European Central Bank and four others today in lowering interest rates by as much as half a percentage point in a coordinated effort to unlock short-term credit markets frozen since Lehman Brothers Holdings Inc. filed for the biggest bankruptcy in history on Sept. 15.

"We've reached the point where so many of these government plans have fizzled that the reaction is reserved until we actually see the impact," said Christopher Low, chief economist at FTN Financial in New York. "They can't stop a recession. What they can do hopefully is prevent a really nasty recession."

The Fed, ECB, Bank of England, Bank of Canada and Sweden's Riksbank each cut their benchmark rates by half a percentage point. The Bank of Japan, whose rate is already 0.5 percent, said it supported the action. Switzerland also took part. Separately, China's central bank lowered its key one-year lending rate by 0.27 percentage point.

'On the Sidelines'

"The reality is there's no private sector balance sheet willing to step in so the Fed and the Treasury are becoming the only balance sheet," said Mark Kiesel, executive vice president at Pacific Investment Management Co., the manager of the world's biggest bond fund. "In a market that lacks trust and confidence the private sector is on the sidelines."

Today's rate cut follows the Fed setting up a fund yesterday to buy commercial paper, seeking to unblock the financing tool that drives everyday commerce for American businesses. The unit will purchase three-month dollar-denominated commercial paper at a spread over the three-month overnight-indexed swap rate.

"I don't expect any significant improvement until the program is up and running," Low said.

The \$1.6 trillion market for commercial paper, which typically matures in 270 days or less, is used by companies to finance payroll, rent and other daily expenses. Issuers post the commercial paper rates they are willing to pay each morning.

Borrowing Options Dwindle

The market slumped last week by a record \$94.9 billion, on a seasonally adjusted basis, led by financials and debt backed by assets, according to Fed data. Average overnight rates on dealer-placed commercial paper soared to an eight-month high of 3.95 percent last week, from 2.08 percent less than

a month ago.

Corporate borrowing options have dwindled as the investment-grade bond market remained all but closed for a fifth week. Companies from newspaper firm **Gannett Co.** to electricity producer **Southern Co.** have been forced to tap credit lines or forego raising debt because of the market's disruption.

Investment-grade bond yields yesterday rose to 7.98 percent, the highest since July 2000, according to Merrill Lynch & Co.'s U.S. Corporate Master index. Spreads relative to Treasuries widened 6 basis points to a record 514 basis points, more than five times their level in February 2007.

Default Risk

Credit-default swaps linked to the debt of retailers including Plano, Texas-based **J.C. Penney Co.** jumped 45 basis points to 320 basis points, according to CMA Datavision, as the economic slump threatens to ruin holiday sales. Contracts on **Nordstrom Inc.** widened 30 basis points to a record 270, and Office Depot Inc. widened 46 to 700, CMA data show.

Credit-default swaps are financial instruments based on bonds and loans that are used to speculate on a company's ability to repay debt. A basis point on a contract protecting \$10 million of debt from default for five years is equivalent to \$1,000 a year. An increase in the contracts suggests deterioration in investor confidence.

The cost to protect against a default on U.S. high-yield, high risk loans also rose, the Markit LCDX index shows. The price of the index, which falls as sentiment deteriorates, dropped 0.5 percentage point to 89.1, according to Goldman Sachs Group Inc.

General Electric

Some direct issuers of commercial paper today lowered the rates they offer on the debt. **General Electric Co.** is willing to pay 1.25 percent on one-day paper, down 65 basis points from yesterday, according to Bloomberg data. GE cut the yield on 30-day paper by 45 basis points to 2.4 percent, the lowest in three weeks, Bloomberg data show. GE Capital, the finance arm of Fairfield, Connecticut-based GE, has \$67.3 billion of commercial paper outstanding, the most of any company.

New York-based **American Express Co.**, the biggest U.S. credit-card company by purchases, reduced its overnight offer rate 25 basis points to 1.75 percent. A basis point is 0.01 percentage point.

Before the global rate cut was announced, the London interbank offered rate, or Libor, that banks charge for such loans jumped 144 basis points to 5.38 percent, the third-straight increase, the British Bankers' Association said today.

The difference between what banks and the Treasury pay to borrow money for three months, the so-called TED spread, widened to 3.87 percentage points, after widening to as much as 4.03, the most since Bloomberg began compiling the data in 1984.

"I do believe over time policy will work," said Kiesel, who oversees \$180 billion of corporate bonds in Newport Beach, California. "The problem with all these measures is it operates with a lag and the deleveraging is real time. The deleveraging cycle is operating on a real time basis much faster than policy can overcome it."

'Stop the Bleeding'

The world economy has already fallen into its first recession since 2001, according to JPMorgan Chase & Co. economists **Bruce Kasman** and **David Hensley**. The U.S. is "definitely in a recession," Low said.

Money-market funds, the biggest buyers of commercial paper, began to flee the market three weeks ago, pushing yields to the highest since January and persuading the Fed yesterday to backstop the market.

Prime money-market funds have pulled \$200.3 billion of assets from commercial paper since Sept. 16, the day after Lehman filed for the biggest bankruptcy ever, and built up their safer government debt holdings instead, according to IMoneyNet Inc., a research firm based in Westborough, Massachusetts,

that tracks money funds.

The central bank interest rate cuts should ``stop the bleeding" in money-market funds, **Peter Crane**, president of Crane Data LLC, a money-fund research firm in Westborough, Massachusetts, said in an interview.

``The rate cuts will help there's no doubt about that," he said. ``For money funds, they're manna from heaven."

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